

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Florez Analyst: Kimberly Pantoja Bill Number: AB 114

Related Bills: See Legislative Telephone: 845-4786 Introduced Date: 01/04/99

History Attorney: Doug Bramhall Sponsor: _____

SUBJECT: Disaster Loss Deduction/1998-99 Winter Freeze

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow special disaster treatment of losses sustained as a result of a freeze or any related casualty that occurred during the winter of 1998-99 in any county of California that was declared a disaster.

This bill also would add provisions to the Revenue and Taxation Code relating to property taxation. These changes do not affect the department and are not discussed in this analysis.

EFFECTIVE DATE

This special disaster treatment of losses applies to the taxable or income year of the loss, which may be 1998 or 1999, depending on whether the taxpayer is a fiscal or calendar year filer.

LEGISLATIVE HISTORY

AB 26X (Stats. 1992, Ch. X16); AB 29X (Stats. 1992, Ch. X18); AB 31X (Stats. 1992, Ch. X26); AB 39X (Stats. 1992, Ch. X25); AB 57X (Stats. 1992, Ch. X23); SB 1370 (Stats. 1992, Ch. 594); AB 900 (1993); SB 357 (Stats. 1993, Ch. 979); AB 1069 (1994); AB 1983 (Stats. 1994, Ch. 1245); AB 2290 (Stats. 1994, Ch. 17); SB 561 (1994); SB 1234 (Stats. 1994, Ch. 33); SB 1317 (1994); SB 1435 (1994); AB 1X (Stats. 1995, Ch. 3); AB 3X (Stats. 1995, Ch. 4); AB 6X (1995); AB 143 (1995); SB 64 (1995); SB 91 (1995); SB 107 (1995); SB 2X (Stats. 1995, Ch. 5); AB 94 (1997); AB 1X (Stats. 1997, Ch. X3); AB 4X (1997); SB 1X (1997); AB 2456 (Stats. 1998, Ch. 749)

SPECIFIC FINDINGS

Casualty Losses

Under current **California and federal law**, casualty losses that are not reimbursed by insurance are allowed to be taken as an itemized deduction in the year the casualty occurred. Each nonbusiness loss is deductible only to the extent it exceeds \$100, and total nonbusiness losses are deductible only to the extent that the total loss amount for the year exceeds 10% of adjusted gross income. However, casualty losses on business property are not subject to the \$100 and 10% of adjusted gross income limitations that apply to nonbusiness property. Generally, business property receives ordinary loss treatment.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Gerald Goldberg

2/25/1999

Both business and personal casualty losses may produce a net operating loss (NOL). **Federal law** allows 100% of the NOL to be carried back for two years and carried forward for 20 years, while in most circumstances, **state law** allows 50% of the NOL to be carried forward for five years.

Disaster Losses

Under federal and state tax law, a taxpayer may claim a loss from a disaster in an area determined by the President of the United States to warrant federal assistance. The taxpayer may elect either to claim the disaster loss in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to immediately file an amended return for the prior year. For state purposes, this election may be made prior to passage of any state legislation allowing special carryback treatment because California conforms to the federal election.

As with casualty losses, nonbusiness disaster losses not reimbursed by insurance are deductible under state and federal tax law to the extent each loss exceeds \$100, and total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of adjusted gross income.

California income tax law identifies specific disasters and allows additional special carryforward treatment. That is, 100% of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, 50% of the remaining excess loss may be carried over for up to 10 additional years.

This bill would add to the current list of specified disasters in the PITL and the B&CTL. Specifically, this bill would allow special disaster treatment of losses sustained as a result of a freeze, or any other related casualty, in the winter of 1998-99 that occurred in any county in this state subject to a disaster declaration. The \$100 and 10% of adjusted gross income limitations in existing law would apply to disaster losses on nonbusiness property.

This special disaster treatment of losses applies to the taxable or income year of the loss, which may be 1998 or 1999 depending on whether the taxpayer is a fiscal or calendar year filer. In addition, current law provides that the loss must be claimed by filing an original or amended return by the due date (determined without regard to extension) for the taxable or income year in which the disaster occurred. This bill provides that the return may be filed by the extended due date for that year.

Policy Consideration

This bill adds to the current list of disasters any losses as a result of a freeze or any related casualty that occurred during the winter of 1998-99. Additional freezes may occur this winter, and any county that receives a disaster declaration as a result of that freeze would qualify for special disaster treatment without further action from the Legislature.

Implementation Consideration

Implementation of this bill would not significantly impact the department.

Technical Consideration

Amendments 1 and 2 have been provided to clarify that the federal disaster loss treatment is allowed for taxpayers when the Governor declares disaster areas that have not been Presidentially declared. Although the President recently declared the areas affected by this bill to be disaster areas, there was some initial concern whether a Presidential declaration would be made. The code section affected by this bill was substantially amended in 1996 to clean up some repetitive language. Prior to that amendment, if the Governor declared a disaster and the legislature listed the disaster in the code section, taxpayers were allowed, for California purposes, to elect to recognize the disaster in the prior taxable year (IRC section 165(i)). Although this special treatment for Governor declared disasters was retained for carryforward purposes, the amendment might arguably be read as having deleted the provision for recognizing the disaster loss in the prior year. These amendments would clarify the potential ambiguity.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Based on the discussion below, the revenue loss from this bill is as follows (assumes fast track legislation before June 30, 1999):

Estimated Revenue Impact AB 114			
Fiscal Year Impact in Millions			
1998-9	1999-0	2000-1	2001-2
(\$2.5)	(\$4.0)	(\$2.0)	(Minor)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Tax Revenue Discussion

The impact of this proposal will depend on the total disaster losses, amounts carried back and carried forward at 100% instead of 50%, and the amount of carryover losses deducted in subsequent years.

The estimated losses were determined in several steps. First, the total amount of damages for the winter freeze of 1998-99 was based on information from the Department of Agriculture and the local news media. According to these sources, damages are currently estimated to be approximately \$634 million (primarily citrus crop losses). It is estimated that approximately 60% of the damage will be reimbursed by insurance coverage. In total, the revenue loss over a period of a few years is estimated to be approximately

\$8.5 million, with approximately 80% attributable to the B&CTL and the balance to the PITL. In the event governmental assistance is forthcoming, estimates would have to be reevaluated. This estimate does not include any future freeze which may occur in 1999.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 114
As Introduced January 4, 1999

AMENDMENT 1

On page 6, strike lines 28 through 32, and insert:

(d) The provisions of this section and Section 165(i) of the Internal Revenue Code shall be applicable to any of the losses listed in subdivision (a) sustained in any county or city in this state which was proclaimed by the Governor to be in a state of disaster.

AMENDMENT 2

On page 9, strike lines 27 through 31, and insert:

(d) The provisions of this section and Section 165(i) of the Internal Revenue Code shall be applicable to any of the losses listed in subdivision (a) sustained in any county or city in this state which was proclaimed by the Governor to be in a state of disaster.